CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
11th July 2013

CABINET
16th July 2013

REPORT AUTHOR: **County Councillor Dai Davies**
Portfolio Holder for Finance

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

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1. Summary

1.1 The Treasury Management Scrutiny Review in 2008/09 recommended that quarterly reports to Board should be adopted. CIPFA also issued a Treasury Management Bulletin in March 2009 highlighting interim advice to local authorities on treasury management practices in the light of the Icelandic Banks collapse and the continuing “credit crunch”. The document suggested:

“In order to enshrine best practice it is suggested that authorities report formally on treasury management activities at least twice a year and preferably quarterly.”

The Revised CIPFA Code of Practice on Treasury Management 2009 and the subsequent 2011 edition emphasised a number of key areas including the following:-

xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation.

1.2 This report, therefore, is providing information on the activities for the quarter ending 31st March 2013.

2. Economic Background and Forecasts

2.1 The economic background is attached at Appendix A.

2.2 The most recent forecast of interest rates by the Authority’s advisor is as follows:

	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB	1.80%	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%
10yr PWLB	2.90%	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%
25yr PWLB	4.10%	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%
50yr PWLB	4.20%	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%

3. Treasury Management Strategy

3.1 Full Council on 1st March 2012 approved the Investment Strategy for 2012/13 as follows:

Long Term Ratings:

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-

Short Term Ratings:

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

"Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

The other situation which could arise is where the Bank has not been fully nationalised but receives substantial support (greater than 50% ownership) from the UK Government. In this case the individual rating is E i.e. the Fitch definition is "A bank which requires external support".

In light of this Sector introduced another colour, Blue, for UK nationalised or part nationalised institutions."

Country Limits:

Country	**Maximum Investment per Country**	**Credit Rating/Other Assessment of Risk**
AAA rated – countries (excluding the UK)	£5M	As per rating list
UK	No Maximum Investment	As per rating list

Group/Institutions - Counterparty Criteria/Limits:

Specified Investments:

Institution	Maximum Investment per Group/ Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	20 (a maximum £10M of this to be held in fixed term investments)	Up to 364 days	As per Sector's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	Up to 364 days	As per Sector's matrices and the Authority's definition of a high credit rating
Other Local Authorities	25	Up to 364 days	N/A

Non-Specified Investments:

Institution	Maximum Investment per Group/Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	10 (£2m limit with any one institution)	Up to 2 years	As per Sector's matrices and the Authority's definition of a high credit rating
Foreign Banks	2	Up to 2 years	As per Sector's matrices and the Authority's definition of a high credit rating
Money Market Funds (max. of 5)	10	N/A	All are AAA rated plus the parents/owners must meet the Authority's short term investment criteria
Other Local Authorities	10	Up to 2 years	N/A
European Investment Bank Bonds	3	2-3 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

3.2 The Authority's investment priorities within the Strategy are: -

(a) the security of capital and
(b) the liquidity of its investments.

3.3 The Authority aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite has been low in order to give priority to security of investments.

4. Current Investments

4.1 The current investment market is difficult in respect of earning the level of interest rates commonly seen in previous years as rates are very low and in line with the 0.5% Bank Rate. The continuing Euro zone debt uncertainty and its potential impact on banks prompts a low risk and short term strategy which means investment returns are likely to remain low.

4.2 The Authority's investment position as at 31st March 2013 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Lloyds TSB	5,000	3.00%	12.06.12	04.06.13
HSBC	1,185	0.25%	N/A	Deposit A/c
Total	**6,185**	**1.36%**		

4.4 Members will note that the Authority's investments have decreased again in the last quarter from £18M to £6M indicating that available cash balances are dwindling as has been predicted in TM reports over the last couple of years. Officers will monitor this for possible borrowing requirements.

4.5 There have been no relevant credit rating changes in the last few months. However, due to the continued uncertainty in the Euro zone, the Authority is currently not making any fixed term investments with any bank other than Lloyds TSB.

4.5 The table above excludes investments still held in Iceland. The Icelandic court granted preferential creditor status for these type of investments in April 2011 and the Supreme Court upheld this decision in October 2011 with 100% Glitnir and 100% Landsbanki monies expected back.

Landsbanki:
The winding up board of Landsbanki made a first distribution to creditors in a basket of currencies in February 2012. An element of this distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 4.17%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland. Further distributions in GBP were made in May and October 2012.

Glitnir:
The winding up board of Glitnir made a full distribution to creditors in a basket of currencies in March 2012. An element of this distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 4.20%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland.

The payment of the funds held in escrow will be made when arrangements have been put in place by the Bank of Iceland to allow transfer of ISK outside of Iceland. Costs to date in respect of the legal representation amount to £38,745.99.

4.6 Redemption Penalties:
The fixed investment listed in the table above is not available for early redemption.

4.7 Investment returns in future years:
Our advisors' current suggested earning rates for investments for budgeting purposes are as follows:-

	Suggested Rate now	Suggested Rate previous
2012/13	0.50%	0.70%
2013/14	0.50%	0.50%
2014/15	0.60%	0.60%
2015/16	1.50%	1.50%

5. Credit Rating Changes

5.1 There have been no credit rating changes relevant to this Authority during the last quarter.

5.2 The credit rating list for end of March is attached as a separate file to this report.

6. Borrowing / Re-scheduling

6.1 Effective management of the Authority's debt is essential to ensure that the impact of interest payable is minimised against our revenue accounts whilst maintaining prudent borrowing policies.

6.2 The Authority's Capital Position:

	As at 31.03.12	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£M	£M	£M	£M
Capital Financing Requirement	193,284	196,696	217,734	226,501

The Capital Financing Requirement (CFR) denotes the Authority's underlying need to borrow for capital purposes. Net external borrowing (borrowings less investments) should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current year and next two financial years. This allows some flexibility for limited early borrowing for future years.

6.3 The Authority currently has outstanding external debt of £145.8M. In relation to the CFR figure for 31st March 2012, this means the Authority was under borrowed at 31st March by £47.5M.

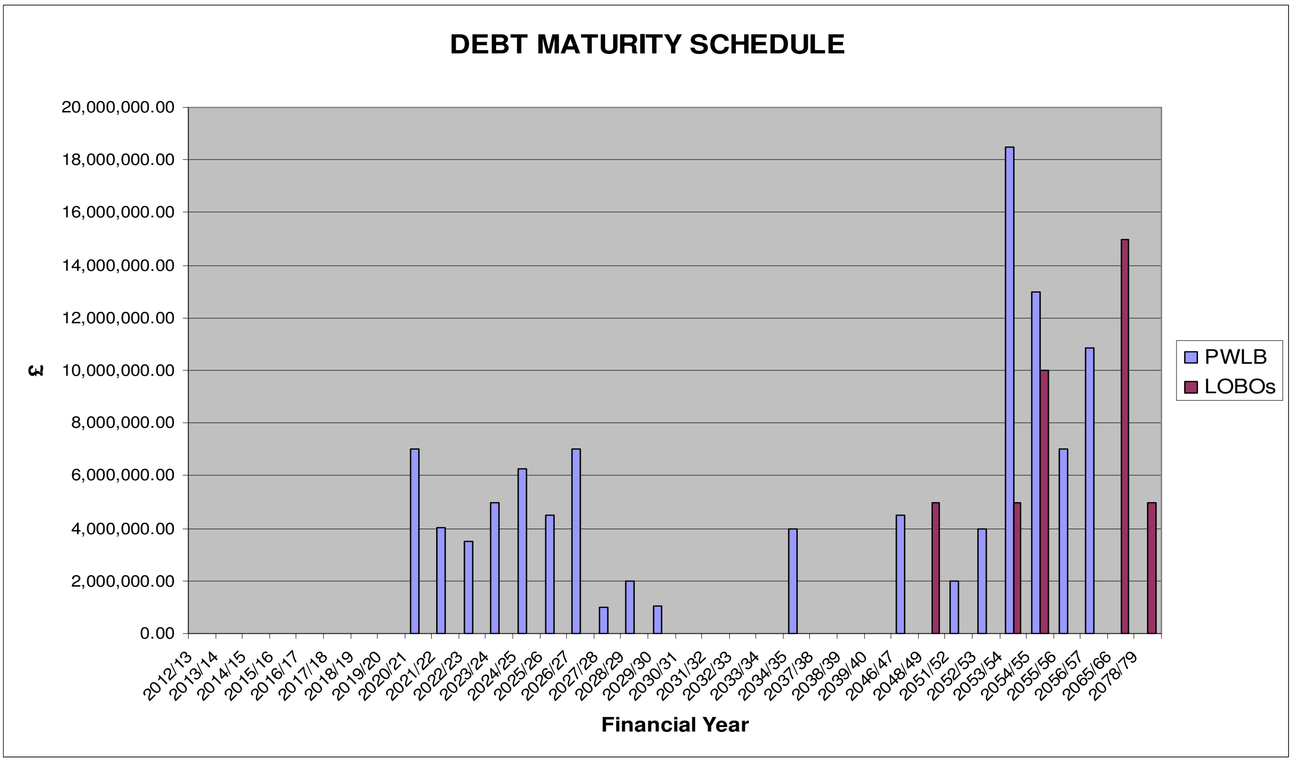
6.4 Capital Budget/Spend per efinancials:

Capital:	**Approved Budget**	**Working budget**	**Capital Spend**	**%age spend**
April	62,849,763	69,447,726	33,300	0.05%
May		70,376,248	2,575,130	3.70%
June		70,871,413	5,824,922	9.20%
July		71,609,254	10,791,779	15.07%
Aug		71,370,919	14,530,307	20.36%
Sept		71,194,874	18,239,889	25.62%
Oct		61,742,664	24,672,548	39.96%
Nov		60,678,148	28,035,097	46.20%
Dec		60,639,343	60,639,343	51.19%
Jan		57,322,381	35,487,270	61.90%
Feb		51,461,391	38,680,259	75.20%
Mar		49,601,183	43,553,826	87.81%
Figs at 13th May		49,896,054	47,204,394	94.60%

The financing of the approved capital budget included £14M of Prudential borrowing.

6.5 *Debt Maturity Profile as at 31.03.13:*

(please click on the graph below and increase the percentage in the toolbar above for an enhanced view)



6.6 As illustrated in the graph above, the Authority may borrow from the Public Works Loans Board or the market (external borrowing). It may also borrow from internal balances on a temporary basis (internal borrowing). The figures in 6.3 above illustrate that the Authority is currently internally borrowed. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing is only a temporary situation and, based on current capital estimates and the decrease in available cash balances, the Authority will need to borrow in the foreseeable future. The Authority needs to be mindful therefore that it may be prudent to borrow whilst interest rates are at their low levels and carry the cost of this borrowing as opposed to borrowing at a future date at increased rates.

6.7 Target rates:

Our advisors' target rates and current PWLB rates are set out below:

Period	Borrowing rate at 31.03.13	Target borrowing rate now	Target borrowing rate previous
5 year	1.87%	1.80%	1.50%
10 year	2.92%	2.90%	2.50%
25 year	4.09%	4.10%	3.70%
50 year	4.22%	4.20%	3.90%

6.8 Rescheduling:

The Public Works Loans Board released a circular regarding rates on 20th October 2010. As a result of this, rates immediately increased by 0.87-0.88 basis points across the board. The overall impact of this circular was that it is far more difficult for authorities to reschedule debt

6.9 Members are aware that officers continue to look for interest savings on a daily basis by monitoring rates that may mean the Authority can re-schedule some of its debt or prematurely repay debt if applicable. However, PWLB interest rates have not been conducive towards rescheduling.

6.10 PWLB Certainty Rate:

In the March 2012 budget report the Government announced that it would introduce in 2012-13, a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. The Government would also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a further reduced rate, to authorities demonstrating best quality and value for money.
This Authority registered its interest in this preferred rate option. Borrowing under this scheme is initially available from 1st November 2012 until 31st October 2013.

7. <u>Prudential Indicators</u>

7.1 All Prudential Indicators were complied with in the quarter ending 31st March 2013.

8. <u>Projects Update</u>

8.1 Income Management System:
As reported in the TM Review Report for 2011/12, TM is taking the lead role in the acquirement of a replacement income management/cash receipting system. This is due to support being withdrawn for the current system at the end of March 2013. Members will appreciate that this is a vital corporate system. At the end of March 2013 the project was in the tendering stage with evaluation, etc. taking place in

April/May. Implementation is timetabled for June onwards. Members will continue to be updated as the project progresses.

8.3 TM continues to work with other service areas on projects/improvements. This currently includes Revenues and Benefits, Customer Services and Leisure.

Proposal

It is proposed that the Treasury Management Quarterly Report is received.

Statutory Officers

Chief Finance Officer's comment:
"The CFO supports the recommendation of the report".

The Solicitor to the Council (Monitoring Officer) has made the following comment:

Future Status of the Report
Not applicable

Recommendation:		**Reason for Recommendation:**	
That the Treasury Management Quarterly Report be received			
Relevant Policy (ies):		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**N/A**
Person(s) To Implement Decision:		**N/A**	
Date By When Decision To Be Implemented:		**N/A**	

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Background Papers used to prepare Report:

CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Treasury Management Policy Statement
Advisors' Information
WAG Guidance on Local Government Investments 2010
PWLB circulars

Appendix A:

Economic Background

General Economy:

"We are, slowly but surely, fixing our country's economic problems" were the words of George Osborne in March as he presented the 2013 Budget. 'Slowly' undoubtedly seems like an accurate description of the economic recovery at present, especially given the halving of the 2013 growth forecast and national debt being predicted to stay high for longer than previously thought. Challenges for the government look set to continue and data releases in March did little to ease the pressures.

Whist Services PMI rose slightly to 51.8 and provided a necessary boost to the dominant services sector, Manufacturing and Construction PMI were not so encouraging, falling to 47.9 and 46.8 respectively. Moreover, the labour market's resilience appeared to fade somewhat this month, with the ILO measure of unemployment rising 7,000 to 2.516 million, providing a blow to the Chancellor on Budget Day. The jobless rate however managed to hold steady at 7.8%, in line with forecasts.

The MPC maintained its key interest rate at 0.5% again in March and opted to leave total asset purchases at £375bn. Minutes of the MPC meeting revealed that the majority of members consider that the costs of more quantitative easing outweigh the benefits for the time being. This does not come as much of a surprise considering Britain's stubbornly high inflation and concerns over asset purchases causing an unwarranted depreciation of sterling. Inflation figures for February are likely to sharpen the debate even further with annual consumer price inflation rising to a nine-month high of 2.8%, driven by a sharp rise in the cost of oil. With growth in weekly earnings slowing and inflation expected to climb further, Britons' budgets will be squeezed more than ever, thereby undermining their ability to drive the economy into a full recovery. As a result, it is becoming questionable as to whether above-target inflation provides a sufficient reason against restarting a bond-buying programme.

Retail sales provided some temporary relief after a dismal January for retailers. Figures showed that retail sales volumes rose 2.1% on the month, versus expectations for a 0.5% rise, and were 2.6% higher on the year. The Office for National Statistics affirmed the rise was thanks to sales in tablet computers as well as goods bought online. Meanwhile, public finances followed this positive trend with PSNB, excluding financial interventions, showing a deficit of only £2.76bn, roughly a quarter of the £11.76bn reported in February 2012. Despite many claiming that the borrowing figures have been artificially flattered, for instance from sales of 4G, this was undoubtedly good news for George Osborne the day after the budget. At face value this would suggest that borrowing could well fall in 2012-13.

Data released towards the close of March proved, as estimated by economists, that GDP growth in the fourth quarter of 2012 did in fact decline by 0.3%, bringing the economy frightfully close to dipping into its third recession in five years. Figures were spurred by a 2.1% decline in industrial production over the quarter, its biggest fall since early 2009.

Housing Market

Mortgage lender Nationwide reported that house prices were unchanged between February and March, but were 0.8% higher than in March 2012. In recent months buyer demand has been supported by healthy rates of employment growth as well as the Funding for Lending Scheme which has helped to reduce mortgage costs and increase credit availability. Nationwide believe the outlook for the housing market to be unusually uncertain at present, in part because the prospects for the wider economy are unclear.